

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

February 24, 2014

Volume 7 Issue 36

Market Overview



Signals Overview

Aggregator	Aggressive VIX	QE Buy Pwr Swing
Flat	50% Long XIV	Flat

Tonight's Research Points

- When SPX closes down but breadth is strong, it has often led to gains over the next few days.
- Liquidity flows were strong last week and will be strong again this week, which should help the bulls as we close out February and head into March.

Short-term Outlook

The Bottom Line

After flip-flopping the last few days, the Aggregator is now about as neutral as can be. I'm inclined to wait for a more solid setup before putting capital at risk.

Summary of Recent Active Studies (see Letters from listed dates for details)

Study Date	Description	Time span	Bias	Avg Max Move
Active - Short Term				
February 24, 2014	SPX down. Up issues % > 55%.	1-3 days	Bullish	1.10%
February 21, 2014	SPX top 10% 10-day range opex Thurs	1-4 days	Bearish	
February 20, 2014	SPX 20-high then close bottom 10% rng	1-8 days	Bullish	2.00%
Active - Long Term				
February 20, 2014	SPY key reversal after 10-high	1-11 days	Bullish	2.30%
December 23, 2014	QE Tapering	int term	Neutral	
December 2, 2013	Nasdaq leading SPX	int term	Bullish	
July 22, 2013	New High Divergence (Study of Tops)	int term	Bearish	
February 1, 2012	Golden Cross	int term	Bullish	

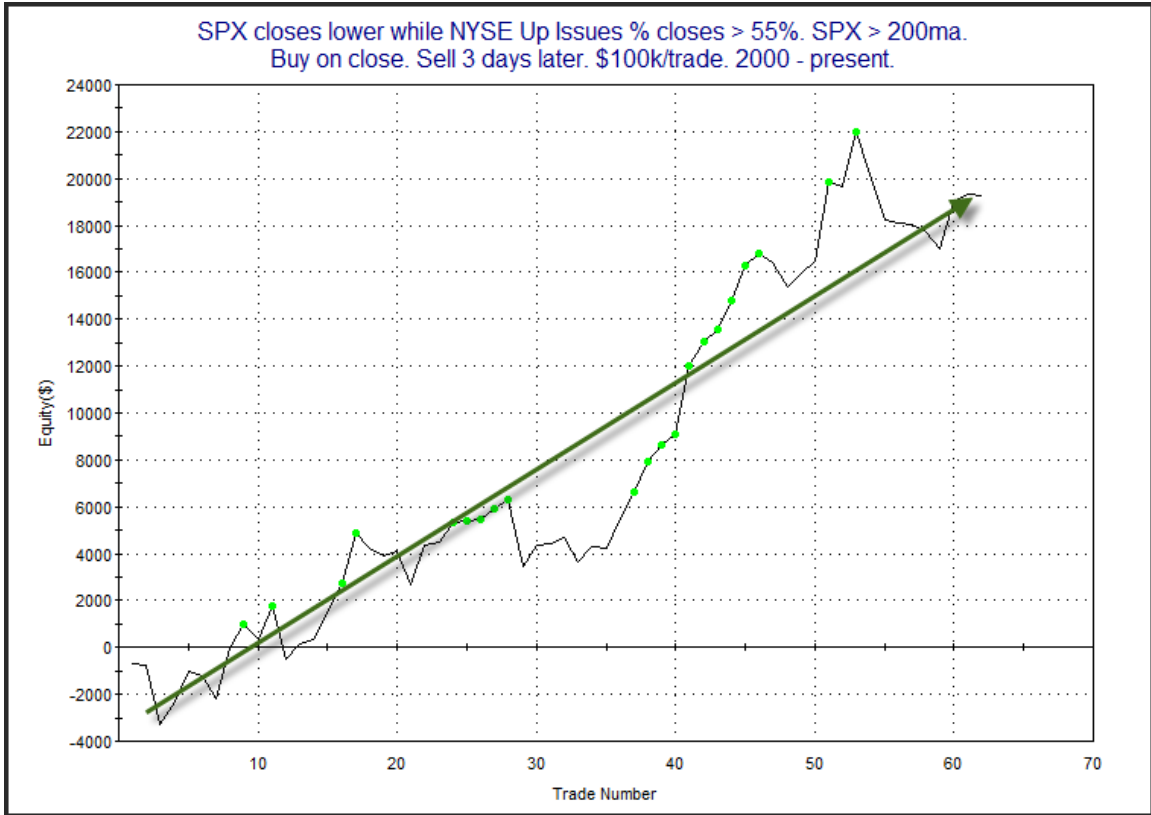
The Evidence

The market finished mixed on Friday. SPX lost 0.2%, the Nasdaq fell 0.1%, and the Russell 2000 rose 0.2%. Breadth was also mixed as the NYSE Up Issues % came in at 57% and the Up Volume % was 48%. Total NYSE volume rose slightly from Thursday's level, but was notably low for an options expiration.

There was not a lot of real notable action on Friday. But breadth was unusually strong for a day that the SPX declined. The study below is the only one from the Quantifinder that I found worthy of discussion. It was last seen in the 1/6/14 Letter. It looks at days like Friday where SPX declined despite strong breadth. Results are updated.

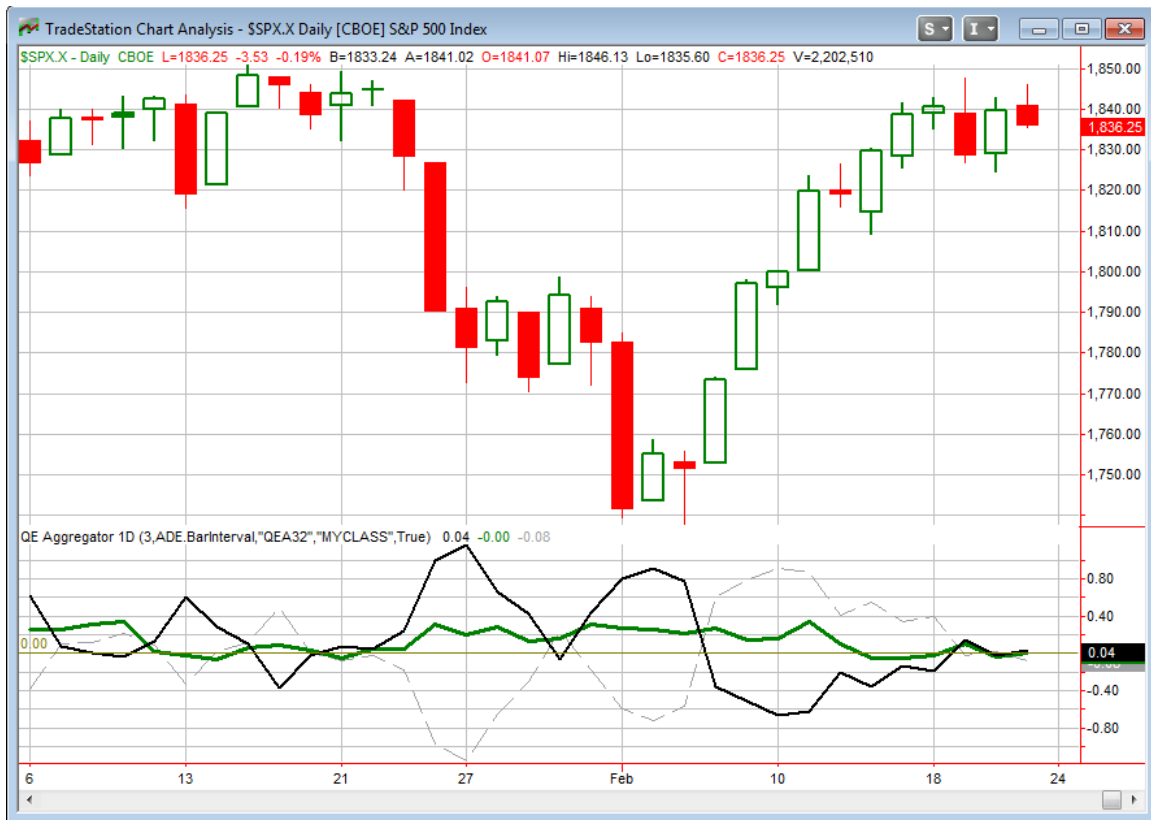
SPX closes lower while NYSE Up Issues % closes > 55%. SPX > 200ma. Buy on close. Sell X days later. \$100k/trade. 2000 - present.												
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	17,348.08	58	34	24	58.62	1,382.15	3,616.92	-1,235.21	-4,012.80	1.12	1.59	299.10
4	17,935.61	60	35	25	58.33	1,299.21	3,429.00	-1,101.47	-2,921.28	1.18	1.65	298.93
3	19,268.61	62	39	23	62.90	1,020.09	3,373.50	-891.95	-2,852.01	1.14	1.94	310.78
2	17,036.04	63	42	21	66.67	817.28	3,025.12	-823.33	-3,119.03	0.99	1.99	270.41
1	13,499.27	65	36	29	55.38	716.87	2,484.00	-424.41	-1,348.29	1.69	2.10	207.68

The edge isn't huge, but it does appear to be worth a closer look. The equity curve below gives a better idea of how it has played out over time.



While the curve certainly appears choppy, it has persisted upwards. I believe this study is worth taking into consideration and I've included it among the active studies.

I have updated the [Aggregator](#) chart below.



Despite the bullish study tonight the green Aggregator Line came in just barely below 0. Negative readings mean net expectations from the Active List are for downside over the next few days. Meanwhile the black Differential Line inched up above 0. The positive Differential Line reading means the SPX is oversold versus recent expectations. So expectations are negative but the SPX is oversold. And both readings are incredibly mild. This is considered a neutral configuration, and with both readings so close to 0, it does not get much more neutral than this. Neutral configurations are visible on the chart whenever both lines close on opposite sides of 0. Therefore the Aggregator signal changed from short to neutral.

Based on the current open studies, expectations are slated to turn positive on Monday. Of course this could easily change if new bearish evidence emerges. The Differential Pivot will be *inverted* at 1828.91 on Monday. That is 0.4% *below* Friday's close. An inverted pivot means the Differential Line will cross zero if SPX closes flat. In this case, SPX will need to close down at least 0.4% in order to remain "oversold" versus expectations. Otherwise it will be considered "overbought".

So the studies are about as neutral as you can get. And I am too. The chop the last few days has done little to generate strong edges. I'll wait for a more favorable reward/risk setup to emerge before taking on my next trade. That normally only takes a few days.

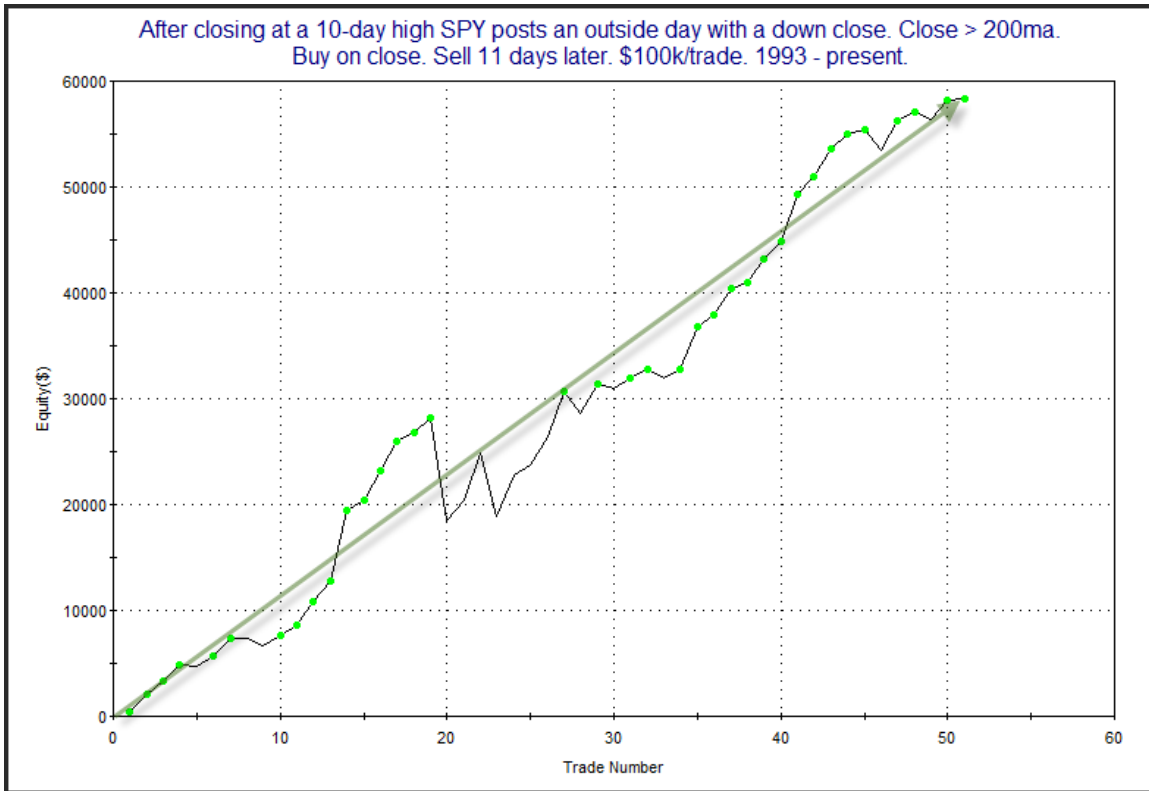
Intermediate-term Outlook (2 weeks – 2 months) – updated 2/24 – neutral

Back and forth trading left to mixed numbers for the week. The SPX declined slightly while the Nasdaq and the Russell 2000 posted gains. The Nasdaq again made new highs, while the SPX and the Russell 2000 are not far from it. Wednesday’s reversal lower led to the lone study with intermediate-term implications. The excerpt below is from Wednesday night’s subscriber letter.

When price makes a new short-term high as it did Wednesday, and then reverses down to form an outside day and closes negative that is considered a "key reversal". I looked at reversals like this a number of times in the past. For the very short-term there rarely appears to be a substantial edge. Often test results will show churn or very mildly bearish numbers. But when you look out 1 to 2 weeks what you often see is that the uptrend most of the time will reassert itself. In the 11/19/13 subscriber letter there was a study that exemplified this. I have updated its results below.

After closing at a 10-day high SPY posts an outside day with a down close. Close > 200ma. Buy on close. Sell X days later. \$100k/trade. 1993 - present.												
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
12	60,317.87	51	38	13	74.51	2,320.34	8,494.78	-2,142.71	-8,389.36	1.08	3.17	1,182.70
11	58,311.37	51	41	10	80.39	1,973.77	6,726.11	-2,261.33	-9,630.04	0.87	3.58	1,143.36
10	42,912.76	52	38	13	73.08	1,758.45	5,990.24	-1,839.10	-5,992.40	0.96	2.79	825.25
9	36,114.56	53	37	16	69.81	1,744.73	5,267.28	-1,777.53	-5,764.17	0.98	2.27	681.41
8	44,695.63	54	36	18	66.67	1,943.45	7,603.99	-1,403.81	-4,587.23	1.38	2.77	827.70
7	36,927.39	55	35	20	63.64	1,887.81	7,694.36	-1,457.30	-4,962.72	1.30	2.27	671.41
6	35,743.55	57	37	20	64.91	1,730.82	5,189.82	-1,414.84	-4,591.36	1.22	2.26	627.08
5	28,485.88	61	39	22	63.93	1,392.34	4,428.81	-1,173.43	-4,346.17	1.19	2.10	466.98
4	6,547.40	61	31	30	50.82	1,424.39	3,915.78	-1,253.62	-4,228.43	1.14	1.17	107.33
3	-4,437.76	61	31	30	50.82	1,058.55	2,930.57	-1,241.76	-3,561.68	0.85	0.88	-72.75
2	-11,502.14	62	26	36	41.94	863.62	2,361.64	-943.23	-3,737.28	0.92	0.66	-185.52
1	-6,816.68	62	31	31	50.00	568.18	1,601.91	-788.07	-3,909.03	0.72	0.72	-109.95

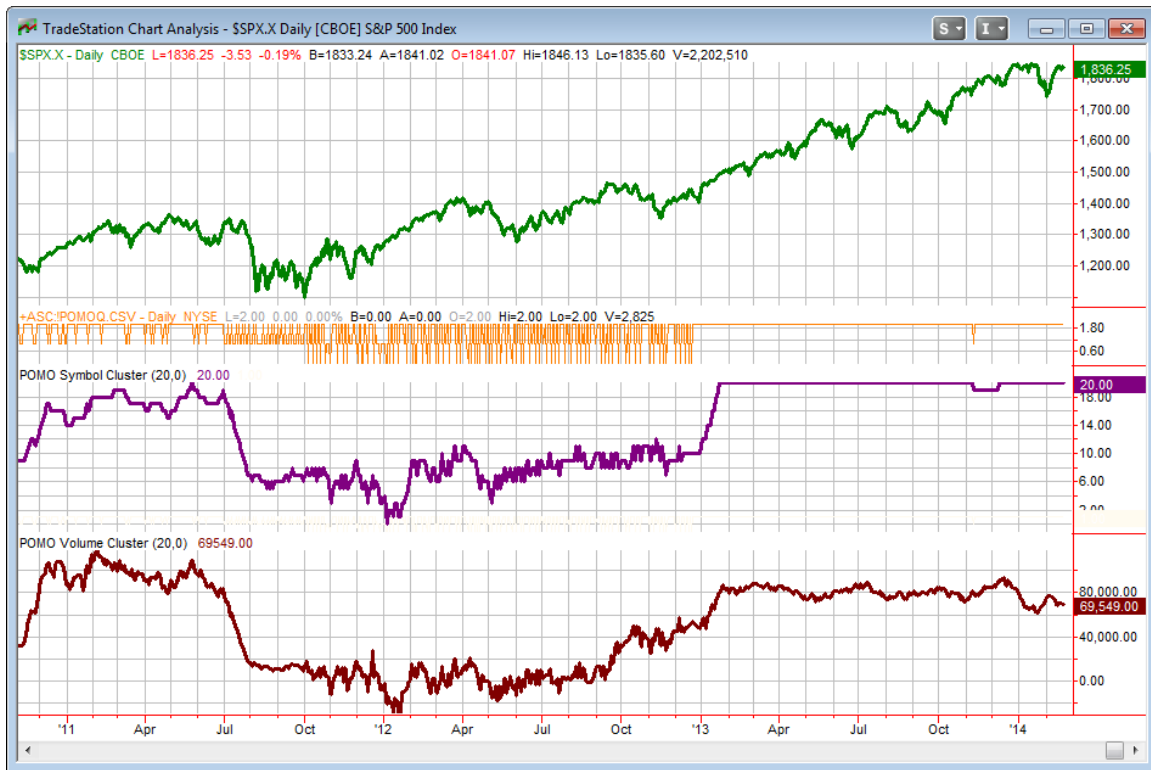
A little weakness over the next couple of days is normal, but before long the move higher sees a continuation. Below is a profit curve using an 11-day holding period.



The strong, steady upslope serve as confirmation of the bullish edge. I have added this study to the intermediate-term active list.

I update the intermediate-term POMO/QE chart each week. For those not familiar, below is a brief description.

POMO stands for Permanent Open Market Operations and it is how the Fed has gone into the open market to buy securities over the last several years. The net effect of this buying is an influx of cash into the system. It appears a portion of that cash makes its way to the stock market and works as a bullish influence. A “POMO Day” is simply a day where these operations take place. The chart below shows a couple of indicators. The top pane is the S&P 500. The middle (purple) pane is the net rolling number of days in the last 20 that have been POMO days. In other words, a day the Fed buys on the market will add +1 while a day of selling will count as -1. The bottom pane is the total amount of money infused into (or taken out of) the system over the previous 20 days. Since the Sept 13, 2012 QE3 announcement the POMO numbers are also adjusted to reflected the Fed’s new approach of buying AMBS securities. Therefore, prior to that date the indicators just look at POMO, since that date it is a combination of POMO and AMBS flows.



The POMO/AMBS days indicator is still riding along at 20, where it spent most of 2013. The volume indicator dipped some this past week, and will be continuing to move at this lower level for a while. We estimate net inflows this past week to have been about \$15.75 billion. This is a pretty sizable amount for a four-day week, and it should help the bulls out this coming week.

This upcoming week should see the biggest liquidity flows of the month, with over \$19 billion expected. So the liquidity backdrop has been improving over the last few days and we should continue to see strong flows into the end of the month. This should favor the bulls. The POMO buying schedule for March will be released on Friday, so it will be interesting to see how that looks going into next month (and the next Fed meeting). For now, liquidity appears to be a short-term positive. The declining levels of Fed buying are still providing stimulus, but less and less. I'm no longer viewing liquidity flows as strongly positive. More like neutral to moderately positive.

On the whole, the outlook remains muddled. The leading Nasdaq remains a positive, as does the Golden Cross formation. The key reversal pattern from Wednesday is also somewhat encouraging. But liquidity is no longer clearly bullish, and the NYSE New High % reading from the Study of Tops has been negatively diverging for some time. I remain willing to trade both sides of the market, though neither with great aggressiveness since I no longer have strong intermediate-term conviction.

Catapult and Capitulative Breadth Statistics

[Catapult & CBI Presentation Link](#)

Open Catapult Triggers

None

Catapult for ETF's Trades

None

Broad Market Large Cap CBI – 0

Additional New Trade Ideas

A full listing of system triggers can be found at the [numbered systems page](#) each night. I will cherry pick some of my favorite setups from the S&P 100 and ETF lists along with occasional other trade ideas to track below.

None tonight.

Current Open Trade Ideas

None

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